

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #99-04**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Application of Tennessee sales and use tax to the sale of certain medical supplies.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[THE TAXPAYER] is engaged in the business of selling medical and surgical supplies, principally to hospitals and major medical centers. The taxpayer seeks guidance in the application of Tennessee sales and use tax regarding these supplies. Specifically, the taxpayer requests a ruling as to whether the following items, as described by the taxpayer, are subject to sales and use tax when sold to a for-profit hospital located in Tennessee:

1. Foley catheter - The Foley catheter is an indwelling urinary catheter retained in the bladder by a balloon inflated with air or liquid. Separate lumens are incorporated within the round shaft of the catheter for drainage of urine, inflation, and introduction of irrigating solutions into the bladder.
2. Foley Catheter tray - The tray includes Foley catheter, lubricant, syringe with sterile water, and miscellaneous items, such as gloves and drapes. The purpose of the tray is to have all the materials necessary for the Foley catheter readily available in one convenient sterile package.
3. Wound drains - This product is a tube or other device by which a channel or open area may be established for exit of fluids or purulent material from a wound or cavity. In some instances suction may be applied to the wound drain. Depending on the circumstances, wound drains may remain in place only for the duration of a surgical procedure (to facilitate the escape of fluids), or alternatively, a wound drain may remain installed for a longer recuperative period of tissue regeneration and healing.
4. Isoflurane - This is a prescription inhalation anesthetic.
5. Epidural with epinephrine - This is a kit or tray containing hypodermic needles, syringes and auxiliary items such as gloves and swabs used when injecting a local anesthetic agent between the vertebral spines. The tray also contains ampules of epinephrine. Epinephrine is a prescription stimulant. Its inclusion in the kit is an emergency precaution as some local anesthetics may produce violent allergic reactions or anaphylactic shock in certain hypersensitive persons.
6. Stockinette - This is a soft elastic, usually cotton, fabric used for multiple purposes. It is sometimes used as a bandage, infant's wear, operating room chaps or headdress, but is frequently used in association with many orthopedic procedures. In these instances, a stockinette will be put on a knee, leg, arm, etc. prior to the application of casting materials. Stockinettes may or may not be sterile.
7. Drain bag (urinary) - This is a bag used to collect urine drained through a urinary catheter. It may be designed to attach inconspicuously to the patient's

body, or in the case of a bedridden patient, it may be designed to hang from a separate stand.

8. Salem sump with anti-reflux valve - This is a double-lumen nasogastric tube used for suction and irrigation of the stomach. One lumen is attached to suction for drainage of gastric contents and the second lumen is an air vent. The valve is to prevent reflux of the stomach contents. Such a tube is frequently installed prior to or during surgery and may remain in place for a period thereafter. It could be used for instilling liquid food or other substances into the stomach, but the Salem sump's primary feature is withdrawal of gastric contents.

9. Salem sump insertion tray - This is the Salem sump in kit form. The kit includes: a Salem sump with attached anti-reflux valve, water soluble jelly, latex gloves, sump tube fastener, towel, alcohol wipe, solution container, piston syringe for irrigation, and a dual-function collection basin and package.

10. Dressings - Included are numerous products of various materials used for covering and protecting a wound. A dressing is usually distinguished from a bandage in that the dressing comes in direct contact with the wound and must be sterile. There are protection dressings, which are applied to shield a body part from injury or from septic infection; and there are pressure dressings, used to maintain constant pressure, as in the control of bleeding. A dressing may contain a drug, antiseptic, antibiotic, moisturizer, or lubricant (such as Vaseline), which may or may not require a prescription.

11. Bandages - Generally a strip or roll of gauze or other material for wrapping or binding any part of the body. Bandages may be used to stop the flow of blood, to safeguard against contamination, or to hold a dressing in place. They may be elasticized, either to provide flexibility of the bandaged area, or conversely to hold a splint in position or to immobilize an injured part of the body to prevent further injury or to facilitate healing. Bandages may be sterile, but frequently are non-sterile, as they may not come into direct contact with an open wound.

12. Surgical staplers and clip appliers - A device for applying a surgical staple or clip to secure apposition of the edges of a surgical or traumatic wound. These products are generally sold with staples or clips. In some cases, the product is constructed so that it cannot be reloaded and is therefore disposable. In other cases, the product can be reloaded with additional staples or clips but is intended for use on a single patient in a single surgical session because it is not designed to be re-sterilized and attempting to do so would invalidate the manufacturer's warranty. Finally, in some cases the product can be reloaded and re-sterilized for continued use. While prices vary among the products, staplers or clip appliers that can be reloaded usually cost substantially more than the price of staples or clips used to reload them.

13. Surgicel - This is a trademark for an absorbable knitted fabric prepared by controlled oxidation of cellulose; it's used as a hemostatic covering for surgical wounds. When saturated, it forms a coagulated mass which stops further bleeding. Surgicel may or may not remain in the body after surgery. If it does remain, it is eventually fully absorbed by body processes.

14. Skin closures - These are called butterfly bandages, steri-strips, cover strips, or suture strips. All are variations of sterile adhesive skin closures designed to hold the edges of a skin wound together.

15. Female catheter kit - This is a disposable catheter used to obtain a urine specimen, without contamination by external organisms. The kit contains a catheter, a collection tube that attaches to the catheter, antiseptic swabs, latex gloves, and specimen label.

ISSUE

Whether these items of tangible personal property, as described by the taxpayer, are subject to sales and use tax when sold by the taxpayer to a for-profit hospital located in Tennessee.

RULINGS

1. Foley catheters are exempt.
2. Foley catheter trays are taxable.
3. Wound drains are taxable.
4. Isoflurane is exempt.
5. Epidurals with epinephrine are taxable.
6. Stockinette is exempt if used to brace, support, or align the skeletal or muscular system. Stockinette is taxable if used as a bandage, infant's wear, operating room chaps or headdress.
7. Urinary drain bags are taxable when used for the stated purpose, to hold urine which has been removed through a urinary catheter. However, if a urinary drain bag is necessary in connection with a urostomy, it becomes exempt from sales and use tax.
8. Salem sumps with anti-reflux valves are exempt.
9. Salem sump insertion trays are taxable.

10. Dressings are taxable.
11. Bandages are taxable, except when used to brace, support, or align the skeletal or muscular system.
12. Nonreloadable surgical staplers and clip applicators are exempt. Reloadable surgical staplers and clip applicators are taxable.
13. Surgicel is taxable.
14. Skin closures are exempt.
15. Female catheter kits are taxable.

ANALYSIS

Under the Retailers' Sales Tax Act, T.C.A. §67-6-101 et. seq., the sale of tangible personal property is generally subject to sales and use tax unless an exemption applies. Several specific exemptions apply to the sale of medical equipment and supplies. The following exemptions are those which are relevant to the items listed in this ruling.

Orthotics and Prosthetics

T.C.A. §67-6-314(5) provides as follows:

There is exempt from the sales tax imposed by the chapter. . .

(5) the sale or repair of prosthetics, orthotics, special molded orthopedic shoes, walkers, crutches, surgical supports of all kinds, and other similarly medical corrective or support appliances and devices.

The Department has applied the exemption for orthotics to devices used to brace, support, or align the skeletal or muscular system. A device is prosthetic if it replaces a missing body part or augments the performance of a natural function. *Cordis Corp. v. Taylor*, 762 S.W.2d 138, 139 (Tenn. 1988). *Cordis* held that an implantable cardiac pacemaker is a prosthesis because it replaces or augments the missing or reduced body function of providing a stimulus for the beating of a heart. *Id.* *Cordis* also held that a hydrocephalus valve system is a prosthesis because it is an artificial part which augments the natural flow of cerebral spinal fluid from the brain into the bloodstream. *Id.*

Ostomy Products

T.C.A. §67-6-317 states:

There is exempt from the tax imposed by this chapter the sale of ostomy products or appliances for use by persons who have had colostomies, ileostomies or urostomies.

Prescription Drugs

T.C.A. §67-6-320 states:

(a) There is exempt from the tax imposed by this chapter any prescription drug or medicine issued by a licensed pharmacist in accordance with an individual prescription written for the use of a human being by a practitioner of the healing arts licensed by the state of Tennessee.

(b) There is also exempt from the tax imposed by this chapter any prescribed drug or medicine sold to a practitioner of the healing arts licensed by the state of Tennessee or issued by a licensed pharmacist for use in the treatment of a human being.

(c) There is also exempt from the tax imposed by this chapter disposable medical supplies such as bags, tubing, needles and syringes dispensed by a licensed pharmacist in accordance with an individual prescription written for the use of a human being by a practitioner of the healing arts licensed by the state which are used for the intravenous administration of any prescription drug or medicine and which come into direct contact with the prescription drug or medicine. This exemption applies only to supplies to be used in the treatment of a patient outside of a hospital, skilled nursing facility or ambulatory surgical treatment center.

1. The exemption for prosthetics, T.C.A. §67-6-314(5), has been applied to catheters which replace a missing body part or augment a body function. The exemption does not apply to catheters which serve as a reparative or surgical tool. Urinary catheters, therefore, are tax exempt prosthetics if used to replace or augment the excretion of urine. On the other hand, I.V. catheters used to deliver drugs to a specific location are not prosthetic devices.

The facts indicate that the Foley catheter is a urinary catheter retained in the bladder by an inflated balloon. Irrigating solutions can also be introduced through the catheter. Because the Foley catheter appears to replace or augment the body's excretion of urine, it is exempt as a prosthetic device.

2. The Foley catheter tray is taxable. While the catheter itself is exempt (see preceding section), the tray and the other items remain subject to tax. If the catheter can be billed separately, then it can be removed from the tax base. If

the charge for taxable and nontaxable items cannot be separated, then the entire charge is subject to tax.

3. Wound drains do not replace a missing body part or augment a body function. They are not exempt under the exemption for prosthetics nor under any other exemptions.

4. To fall under the prescription drug exemption, the item must be: 1) a drug or medicine; 2) prescribed by a physician; and 3) sold to a physician or issued by a pharmacist to an individual. Assuming these requirements are met, isoflurane is exempt from sales and use tax.

5. The facts describe a kit which contains items necessary to administer an anesthetic agent into the spinal area. The tray apparently does not contain the anesthetic. It does, however, contain the drug epinephrine for emergency use in case of an allergic reaction. While epinephrine by itself might qualify as an exempt prescription drug, its inclusion does not make the kit exempt. The kit is subject to sales and use tax.

6. The Department has applied the exemption for orthotics, T.C.A. §67-6-314(5), to devices used to brace, support, or align the skeletal or muscular system. As described in the facts, stockinette is often put on a knee, leg, arm, etc., prior to application of casting materials. When used in this manner, stockinette is exempt from sales and use taxation. However, stockinette is sometimes used as a bandage, infant's wear, operating room chaps or headaddress. When used for these latter purposes, stockinette is not subject to the exemption. When tangible personal property is purchased for multiple purposes, it is the primary intended purpose which governs taxability. See Op. Att'y Gen. 84-213, 1984 Tenn. AG LEXIS 134. Thus, if a unit of stockinette is purchased for both taxable and nontaxable purposes, it is the primary intended purpose which dictates whether it is subject to tax.

7. The stated purpose of the drain bag is to hold urine which has been removed from the body through a urinary catheter. When used in this manner, a drain bag is not subject to any exemption and is therefore subject to sales and use tax.

It should be noted, however, that there is a specific exemption for products used by persons who have had a urostomy. T.C.A. §67-6-317. Thus, a urinary drain bag used by a urostomy patient would qualify for this special exemption.

8. The Salem sump is primarily used to remove the contents of the stomach. It can also be used to instill liquid food or other substances into the stomach. Filling and emptying the stomach are clearly functions of the body. Consequently, the Salem sump with anti-reflux valve qualifies as a prosthetic device, exempt from sales and use tax.

9. The Salem sump insertion tray is taxable. While the Salem sump itself is exempt (see preceding section), the tray and the other items remain subject to tax. If the Salem sump can be billed separately, then it can be removed from the tax base. If the charge for taxable and nontaxable items cannot be separated, then the entire charge is subject to tax.

10. through 14. The body's activity in causing closure or healing of a wound is a natural function of the body, and any item which replaces or augments this function will be exempt as a prosthetic device under T.C.A. §67-6-314(5). Therefore, exemptions have been allowed for surgical sutures, metal clips, and staples because they are used to close a wound or incision, clearly adding to the healing process. On the other hand, items which simply cover and protect the wound while it heals do not actually replace or augment the healing process. Therefore, the Department has previously held that gauze and medicated bandages are taxable.

Applying these principles to the facts presented, dressings and bandages are subject to sales and use tax because their purpose is to cover and protect the wound. The only exception to this finding is the situation, described in the facts, in which a bandage is used to hold a splint in position. The Department has previously applied the exemption for orthotics to elastic bandages when they are used to brace, support, or align the skeletal or muscular system.

Surgicel is described as a hemostatic covering for surgical wounds. It appears to perform the same function as a dressing. Thus, surgicel is subject to tax.

Staplers and clip appliers are devices used to apply surgical staples or clips. As noted above, the prosthetic exemption has been applied to metal clips and staples when used to enhance the body's healing process by closing a wound or incision. However, T.C.A. §67-6-314(5) exempts the prosthesis itself. It does not generally exempt surgical tools used to apply the prosthesis.

Under the facts provided, there are three different types of staplers and clip appliers. One type is sold with the staples or clips inside and is constructed so that it cannot be reloaded with additional staples or clips. This type is considered disposable because it is useless and valueless after the preloaded supply of staples or clips are exhausted. The Department has taken the position that a disposable unit and the staples and clips inside it constitute a single item which qualifies for the exemption under T.C.A. § 67-6-314(5).

The second type can be reloaded with additional staples or clips but is intended for use on a single patient in a single surgical session because it is not designed to be re-sterilized and attempting to do so would invalidate the manufacturer's warranty. The third type can be reloaded and re-sterilized for continued use. These units, whether or not they can be reesterilized, are not considered by the Department to be disposable because they have value and usefulness after the

preloaded staples or clips are exhausted. The units can be reused by loading additional staples or clips. Consequently, these reloadable units are not exempt from sales and use tax under T.C.A. § 67-6-314(5). If the staples or clips can be billed separately, then they can be removed from the tax base. If the charge for the nontaxable staples or clips and the taxable stapler or clip applier cannot be separated, then the entire charge is subject to tax.

Skin closures, described as sterile adhesive devices designed to hold the edges of a skin wound together, appear somewhat similar to a bandage. However, the described purpose of these items is not to cover and protect the wound. Rather, the purpose is to enhance the healing process by closing the wound in the same manner as a metal clip or staple. Consequently, these items are exempt from sales and use tax.

15. The female catheter kit is used to obtain a urine specimen without contamination by external organisms. It is not used to replace or augment the body's excretion of urine. No exemptions apply to this device. It is subject to sales and use tax.

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APPROVED: Ruth E. Johnson, Commissioner

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